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FM AMEMBASSY ISLAMABAD
TO RUEHC/SECSTATE WASHDC 9903
INFO RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUCPDO/DEPT OF COMMERCE WASHINGTON DC
RUEHML/AMEMBASSY MANILA 3071
RUEHBUL/AMEMBASSY KABUL 9368
RUEHNE/AMEMBASSY NEW DELHI 3998
RUEHLO/AMEMBASSY LONDON 9054
RUEHKP/AMCONSUL KARACHI 0583
RUEHLH/AMCONSUL LAHORE 6317
RUEHPW/AMCONSUL PESHAWAR 5162
RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL
RHMFISS/CDR USCENTCOM MACDILL AFB FL
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SUBJECT: MONEYCHANGERS ARRESTED TO PRESERVE FOREIGN EXCHANGE

11. (U) Summary. At least four money changers, including a CEO of a leading foreign exchange company, were arrested on November 8 by Pakistan's Federal Investigation Agency (FIA) for smuggling and illegal cross border transfer of foreign exchange. The FIA is closely watching other exchange companies to curb further cross-border smuggling of dollars. According to FIA sources, the case has been registered under the Foreign Exchange Regulations Act, which does not specify severe penalties for such crimes. FIA sources estimate that foreign exchange sent out of country could be in the millions of dollars. The rupee appreciated from 81 to 80 rupees per USD after the arrests. Portfolio investment flight has put downward pressure on the rupee, especially net outflows of USD 253.52 million from the stock market since July 2008. End summary.

12. (U) The FIA arrested four members of Khanani and Kalia International (KKI, a leading exchange company headquartered in Karachi) in Lahore, Karachi, and Gujranwala last week for illegally transferring foreign currency abroad. The most prominent are Javed Khanani, CEO of Khanani and Kalia International and General Secretary of Exchange Companies Association of Pakistan, and Munaf Kalia, Director of Khanani and Kalia International. For the last three weeks the State Bank of Pakistan (SBP) has been reviewing exchange companies to ascertain the causes of recent rupee depreciation and requested the government to clamp down on exchange companies suspected of involvement in illegal transfer of dollars. After the arrests the rupee appreciated from 81 to 80 rupees per USD.

13. (U) The Director of Interpol at FIA, Syed Asif Akhtar, said that the case has been registered under the Foreign Exchange Regulations Act of 1947 (FERA) for capital flight, which does not require severe penalties for such crimes. FIA alleges that KKI was involved in physical transfer of foreign currency from Pakistan and ran a Hawala or Hundi business. Hundi and Hawala systems are explicitly banned under section 4 of FERA. However, since they conduct undocumented business it is difficult to identify or monitor them. Akhtar also said that they are still not sure how much foreign exchange has been transferred as the investigation is still underway but their estimates are in the range of millions of dollars.

14. (U) On November 6, an FIA team raided a franchise of KKI in Gujranwala and arrested two employees, with evidence of illegal currency transfer. FIA then raided the head office of KKI late November 7. FIA took all records, computers, hard disks and data of foreign currency transactions and sealed the office. Two forensic experts are analyzing the seized computer records. Future raids and arrests will be made in the light of information retrieved.

¶5. (U) A delegation of exchange companies met FIA officials in Karachi to petition for the release of the KKI employees. The request was denied. These arrests have caused concern among money changers in Lahore, as FIA continues to monitor money changers for illegal transfers. Some money changers who normally did business on Sundays remained closed on November 9, for fear of FIA raids. According to one of their representatives, their business will remain closed on Monday as well.

¶6. (SBU) In addition to flight of capital through illegal means the equity markets of Pakistan have also witnessed the capital outflows. The net outflow from the Convertible Rupee accounts during November 1 to November 7 has been USD 1.497 million while the net outflow from July 1 to November 7th has been USD 253.52 million. Together these have put a pressure on rupee.

¶7. (SBU) Comment. The arrests are symptomatic of a deteriorating liquidity crisis in Pakistan, as foreign exchange reserves have been depleted to less than one month's imports and external financing fails to materialize. The enforcement measures may encourage transmission of more remittances from expatriates through the formal banking sector, which could improve banks' foreign exchange balance sheets. Unfortunately, they could also feed speculation and promote capital flight. End Comment.

PATTERSON